

Regulatory Flash

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From the editor

During the Trends in Innovation in the Postal Market Conference organised by IPC in cooperation with the Ecole Polytechnique de Lausanne in Lausanne in September, IPC took the opportunity to interview two of the conference speakers about regulatory affairs. Another speaker, Fabio Filpo of FratiniVergano-European Lawyers, wrote a feature article for this issue also.

USO financing: regulatory expectations under the SGEI package reform and the Lisbon Treaty

Interview with Alessandra Fratini, Partner, FratiniVergano, European Lawyers



Q. How does the application of the Community Framework on SGEI interact with the Third Postal Directive?

A. In order to qualify the public financing of universal postal service as compatible State aid, the current SGEI Framework actually requires i) that the SGEI must have been entrusted

by way of an official act specifying, inter alia, the parameters for calculating, controlling and reviewing the compensation and the arrangements for avoiding and repaying any overcompensation and ii) that the amount of compensation does not exceed the costs of discharging the public service obligations (taking into account the relevant receipts and a reasonable profit).

The Commission's compatibility assessment depends in a number of instances on the specificities of given sectors and their own regulation. In the postal sector, Annex I of the third postal directive has introduced a new methodology to calculate the net cost of the Universal Service obligations that may be compensated, which will be relevant when it comes to verifying the compatibility of USO cost compensation with the SGEI Framework.

However, Annex I is not entirely consistent with the SGEI Framework as it currently stands. While the latter is based on full cost allocation, the Annex I methodology only allows compensation for the net costs that would have been avoided in the absence of the USO (i.e. for the difference between the net cost for a designated Universal

Service provider of operating with the USO and the same postal service provider operating without the USO).

Therefore, it is still to be understood to what extent the application of the SGEI Framework may be made conditional upon the application of Annex I methodology. We look forward to receiving some clarifications in this respect in the forthcoming SGEI reform.

Q. The new Article 14 TFEU (ex 16) of the Lisbon Treaty gives the EU greater power to put in place EU-level legislation and secondary legislation on SGEI. On the other hand, the new protocol 26 emphasises the primary role of Member States in organising SGEI in their territory. How significant is the impact of the Lisbon Treaty on SGEI, and in particular on the universal postal service?

A. It is true that Article 14 TFEU introduces a new legal basis to establish economic and financial conditions for the functioning of SGEI. It could be employed to strengthen the Universal Service, to introduce more detailed EU regulation (for instance, Commission President Barroso introduced the idea of a 'quality framework' for public and social services) or to deal with some specific aspects concerning public services (e.g. the application of EU public procurement rules to SGEI). However, the possibility of introducing such EU regulation rests upon the political will of the EU legislator. This is a sensitive matter, where Member States' interests and positions vary considerably, and it requires a careful subsidiarity check, to make sure that the EU legislator does not step into matters which fall within the jurisdiction of the Member States.

Conversely, as the provisions of Article 14 TFEU are without prejudice to Articles 106 and 107 TFEU (i.e. to competition rules applicable to undertakings and State aid), a future Regulation under Article 14 TFEU is likely to be of no relevance to State aid, and in particular to USO cost compensation, as these matters fall within the Commission's exclusive power of State aid control, under Article 106 TFEU. While I'm a bit sceptical on whether there will ever be such a Regulation, it is clear that, should it be adopted, it would not give much added value to the postal sector and certainly nothing new will come as far as USO financing is concerned.

Q. What should we expect regarding the SGEI reform, and what will the implications be on USO financing?

A. Competition Commissioner Almunia anticipated that the SGEI reform would most likely include three instruments: a Communication clarifying the key concepts which are difficult to interpret in their present form; a Decision implementing a simpler and more flexible approach for local services and some social services; and a Framework that will apply to large compensation amounts for larger, more commercial SGEI. The latter will be of particular interest for the postal sector. The Communication will explain some of the concepts, and that is welcome especially in connection with the fourth Altmark criterion. The most relevant instrument will be the Framework, as an efficiency requirement in the assessment of the compatibility of the compensation is expected to be introduced and this raises a number of questions.

Q. What do you think about the introduction of efficiency criteria for the assessment of State Aid?

A. My personal view is that the efficiency check is already done when you run the Altmark test to see whether a given measure is State aid or not. If the efficiency criterion is complied with, the measure is not State aid. If it is not, then the compatibility assessment is completed to see whether it is authorised under Article 106(2) TFEU. Now the Commission's plan is to introduce efficiency criteria in the second part of the analysis, the compatibility assessment which I think risks depriving the whole Framework of any utility: either the measure matches the efficiency criteria and then it is not State aid, or it doesn't and it goes through the assessment under the Framework. The efficiency comes back in at this stage of the analysis and becomes almost a superfluous requirement because if it has not been met at the first stage it cannot do either at the second stage. We will see how it is finally defined, maybe in terms of quality performance requirements more than economic efficiency. Opposition has been voiced by a number of Institutions with a view to defending the discretion of Member States to select, identify and organise their SGEI: an efficiency requirement at that stage might impinge on the full freedom of Member States and create an institutional clash.

2011 regulatory institutions, governance, costs and innovation in post: an international comparison

Interview with Martin Maegli, Head of Regulation at Swiss Post's department of public affairs and corporate responsibility



Q. Could you please explain the framework of regulatory governance costs that you developed? What is the impact of these governance costs on innovation?

A. We say that the implementation of the regulatory framework comes at a cost: regulatory governance costs. Such costs are determined and influenced by the institutional design, the behaviour of the actors involved in the market (regulators, operators and political actors) and the choice of regulatory instruments. The costs are related to tasks performed to sustain competitive and fair markets, to set incentives for the actors involved to provide a certain level of public service, and to set incentives for innovation and to coordinate public actors involved in regulation. Therefore we distinguish three types of regulatory governance costs: direct costs relating to monitoring activities such as compliance and coordination between regulatory actors; indirect costs relating to quantity, prices, capacity and technology choice in the market; and finally dynamic costs which are the consequence of direct and indirect costs, and we say that these dynamic costs result from distorted innovation and investment incentives.

Q. In what way are innovation incentives affected by regulatory institutions?

A. Dynamic costs from regulatory governance may result in a poor level of product and process innovation. When

talking about product innovation, regulation may prevent operators from introducing new products and services because there is uncertainty about the return on investment and the pricing of products or services. It may also result in a delay of time to market due to price approval procedures. Regarding process innovation, regulation can result in sub-optimal processes and prevent operators from optimising or introducing new process innovations. For example if the scope of the Universal Service is very rigidly defined existing processes or products cannot be abandoned. If there is regulation on prices there might be a delay in time to market or new products may not be attractive for providers or consumers.

Q. What should the future regulatory approach be? Can regulatory bodies meet the challenges of competition and e-substitution effects?

A. Last year we published an article about converging markets and how regulatory institutions should evolve. There we played with the idea that there should be a unified universal service approach for the communications market. Due to e-substitution the postal and communications markets really converge into one single communications market. Of course, it is too early to implement such a unified approach but maybe it is the way to think. There is already an institutional trend to observe: formerly separated regulatory bodies are transformed into larger cross-sectoral regulators that deal with communications. Those that handle postal regulation move closer to telecommunications regulatory bodies. Nevertheless, whether there is a real need for sector-specific regulation in the postal sector remains an outstanding question.

The following question was posed to both Alessandra Fratini and Martin Maegli:

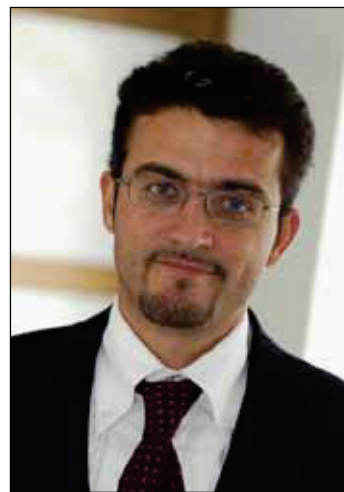
Q. Do you, Alessandra and Martin, see changes in regulatory framework in the context of the liberalisation process?

Alessandra: Not really. From an EU point of view, the current directive is going to stay. The amendment adopted in 2008 removed the sunset clause from the text of the directive. Maybe we can expect a fourth postal directive

at the European level, but I believe the process cannot start before the second group of Member States have implemented the third directive and the Commission has issued its evaluation report. At the earliest a proposal would be made in 2014-15 so until then this directive remains in force, including the definition of Universal Service under Article 3.

Martin: As I already mentioned, I see changes. Given changes in the market, regulatory institutions must respond and evolve with this development and changing consumer needs. By definition regulatory institutions are static: The political discussion on regulatory institutions is a reaction to an observation from the past. Experts carry out analyses which can start a discussion about a regulatory framework or the role of public services, for example, on a new European postal directive or the new postal law in Switzerland. The discussion on regulatory institutions is a very slow reaction to the past. I don't know how to solve the problem or how to accelerate this institutional process, it may be impossible. Postal operators really need to be able to address declining mail volume, e-substitution and changing consumer needs without struggling with obsolete regulatory institutions.

The reform of the EU rules on State aid to Services of General Economic Interest



*Feature article
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The current SGEI Package – and in particular the Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (OJ 2005/L 312/67) and the Community framework for State aid in the form of public service compensation (OJ 2005/C 2974) – is to be replaced by four new measures, whose draft measures were published by the Commission on 16 September:

Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, which clarifies the key concepts underlying the application of State aid rules to public service compensation (i.e. the concepts of undertaking and economic activity, State resources, effect on trade) and recalls the conditions under which the Court of Justice of the EU has established that the compensation of the net cost of the SGEI does not constitute State aid (Case C-280/00, Altmark);

Commission Decision on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (aimed at replacing the currently applicable 2005 Decision), which defines the aid measures which are automatically

compatible under Article 106(2) TFEU (i.e. not subject to prior notification, standstill obligation and approval by the Commission), namely: SGEIs for an annual amount of less than € 15 million, hospitals providing medical care and emergency services, some services meeting essential social needs and some specific SGEIs in the air or maritime transport sectors.

EU framework for State aid in the form of public service compensation (aimed at replacing the currently applicable 2005 Framework), which specifies the conditions under which aid measures – which do not fulfil the Altmark criteria and do not fall under the Decision – may be declared compatible by the Commission.

Commission Regulation on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid granted to undertakings providing Services of General Economic Interest, which establishes that compensation for the provision of SGEIs does not constitute State aid provided that it is granted by a local authority representing a population of less than 10,000 inhabitants, that it benefits an undertaking with an annual turnover of less than € 5 million during the two preceding financial years and provided that the total amount of compensation does not exceed € 150,000 per fiscal year.

Of particular relevance for the postal sector is the EU Framework which recalls the current principles and introduces, amongst others, new provisions on the calculation of the net cost and of the reasonable profit which can be attributed to the SGEI.

The net cost of the SGEI is calculated, where possible, on basis of the 'net avoided cost methodology' and with reference to sector-specific regulation, where available (as to postal services, the Framework expressly refers to Annex I to Directive 97/67/EC, as last modified by Directive 2008/6/EC); in the alternative, the Framework establishes a methodology based on a cost allocation, according to which "the net cost necessary to discharge the public service obligations can be calculated as the difference between the costs and the revenues for a designated provider of fulfilling the public service obligations".

The reasonable profit which is to be taken into account when calculating the net cost is defined with reference to the rate of return on capital in the relevant sector or to other indicators (e.g. the average return on equity, return on capital employed, return on assets or return on sales), being established that "a rate of return on capital that does not exceed the relevant swap rate plus a premium of 100 basis points is regarded as reasonable in any event". Specific provisions are also introduced as to risk evaluation.

The Commission favours efficiency incentives to be introduced by Member States, for instance by defining "a fixed compensation level which anticipates and incorporates the efficiency gains that the undertaking can be expected to make over the lifetime of the entrustment act" or by defining "productive efficiency targets in the entrustment act whereby the level of compensation is made dependent upon the extent to which the targets have been met" and, if these are not met, reducing the compensation "following a calculation method specified in the entrustment act".

The measures are currently subject to public consultation and are to be adopted by end of January 2012.

